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Nondisclosures by Sellers, Brokers, and Home Inspectors

ROGER BERNHARDT

Midcourse Correction is not a very appropriate title for this particular column, as there is little to change in one's practice as a result of the decisions in *Leko v Cornerstone Home Inspection* (2001) 86 CA4th 1109, 103 CR2d 858 (reported on p 123) and *Expressions at Rancho Niguel Ass'n v Ahmanson Devs., Inc.* (2001) 86 CA4th 1135, 103 CR2d 895 (reported on p 119). Nonetheless, the decisions are worth noting because of their extensive and intelligent coverage of so many legal issues. They resolve several questions, so I am going to use them as an occasion to summarize the many issues involved when real estate purchasers believe that someone didn't tell them the full story about the condition of the property they acquired and want to sue someone because of it.

If you represent the seller's side of the situation, the advice to give beforehand is pretty simple and unqualified: When you possess important information about the property, disclose it. Hiding anything other than certain legally protected facts (such as the race of one of the parties or a neighbor, or that the seller has AIDS) will probably make your client liable, if he or she is at all involved in the transaction. If the failure to disclose has already occurred, what follows may shed some light on the question of whether to settle or litigate.

1. *If a seller or one of the brokers or a home inspector conceals or intentionally fails to disclose defects in the property to the buyers, is there liability?* Yes, and the suppression is probably fraud (except for legally protected facts like those mentioned above). Even if the information does not materially affect value, buyers can still rescind if they can show that the undisclosed fact was important to them personally.

2. *If a seller, broker, or home inspector negligently fails to discover or disclose defects in the property, is there liability?* Sometimes. As a prerequisite, the defendant must owe a duty to disclose to the buyer, and that is not always the case.

a. *Sellers.* Sellers of real property owe a duty to disclose material facts to their buyers, but only if they actually know of those facts. Sellers do not have a duty to inspect to find out the condition of the property and then report it to the buyer. (The Real Estate Transfer Disclosure Statement (TDS), prescribed for one- to four-unit residential properties, asks sellers to declare what they are "aware" of, in contrast to the broker's part of the TDS, which requires a "reasonably competent and diligent visual inspection." CC §1102.6. In sales of larger properties (*i.e.*, more than four units), in which no TDS is required, noninspection and/or nondisclosure is even less likely to be actionable.)

Although the duty to disclose known defects may tempt sellers to keep their eyes closed as much as possible, I doubt that sellers who have "reason to know" of a defect (*e.g.*, as evidenced by the presence of similar conditions elsewhere on the premises) are safe in failing to relay that information to the buyers or to one of the brokers in the deal. The fact that one has no affirmative duty to investigate is not the same as being entitled to shut one's mind to the obvious inferences of what one already knows about the property.

In summary, if sellers know or have reason to believe that the plumbing leaked or the foundation sagged, they better disclose that fact; but if they truly don't know about a problematic condition, they do not have to go looking for it before the sale.

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b. *Home Inspectors.* The business of home inspection is governed by Bus & P C §§7195–7199 and is defined as “a noninvasive, physical examination, performed for a fee in connection with a transfer . . . of real property.” Bus & P C §7195(a). Section 7196 imposes a clear duty on home inspectors “to conduct a home inspection with the degree of care that a reasonably prudent home inspector would exercise.” Although that standard seems somewhat circular, the legislative preamble instructs courts to “consider the standards of practice and code of ethics” of the California Real Estate Inspection Association (CREIA) and the American Society of Home Inspectors (ASHI), both of which have detailed and usable standards. Furthermore, Bus & P C §7198 explicitly makes the inspection duty nonwaivable, which I assume means that it is also nonmodifiable. Although “home inspection” is limited to the examination of a “residential dwelling of one to four units” (Bus & P C §7195(a)), it is unlikely that a person who inspects a five-unit building owes a different duty, because the CREIA and ASHI standards don’t limit themselves to these smaller residential units.

The statute only hints at who is to be benefited by careful home inspection. Its preamble says its purpose is to “assure that consumers of home inspection services can rely upon the competence of home inspectors,” but the “consumer” could often be the real estate broker rather than the buyer of the property being inspected (as was partly the case in *Leko*). ASHI standards state that they are intended to help buyers, while CREIA standards refer to clients rather than buyers. Despite the statutory vagueness, *Leko* is pretty clear on this matter. By holding negligent home inspectors liable not only to their own nonpurchasing clients, but also to subsequent purchasers who did not even pay for the report, the court ruled that home buyers are the parties protected by the statute and, accordingly, the ones owed the duty of care.

Leko denies negligent home inspectors the defense of lack of privity, and also makes it clear that they cannot create this defense through contractual language. The court held that a declaration in the report that it may not be used by anyone else would not preclude a finding that the inspector could reasonably foresee that third parties would rely on the report. That makes it pretty unlikely that a better-drafted protective clause would make much of a difference. A negligent home inspector is probably going to be liable to whichever reader of the report ends up buying the property. Whether that also applies to a resale (*B* purchased from *A*, who first ordered the report), rather than a sale to an alternative buyer (*B* purchased instead of *A*) is much less clear.

Comparing sellers with home inspectors, sellers may not have negligence liability, but inspectors will (both as to the first and later buyers). In the case of intentional concealment, both sellers and inspectors face liability, and that liability likely runs beyond the first purchaser. See my article, Bernhardt, *You Can Sell But You Can’t Hide*, 18 CEB RPLR 182 (May 1995).

c. *Brokers.* The question of what duties brokers owe is trickier because the variables of agency status and type of property qualify any answer. When a one- to four-unit dwelling is involved, a broker representing the buyers owes them “a fiduciary duty of utmost care, integrity, honesty, and loyalty,” whereas a broker who represents only the sellers owes the buyers “[d]iligent exercise of reasonable skill and care . . . honest and fair dealing and good faith . . . [and a] duty to disclose all facts materially affecting the value or desirability of the property” that are known to the broker but not known to the buyers. CC §2079.16. A dual agent seems to owe the buyers both such duties. See CC §2079.16. (I have commented elsewhere on the absurdity of these definitional distinctions; see my article referenced above.) In addition, a seller’s broker has a duty “to conduct a reasonably competent and diligent visual inspection of the property offered for sale and to disclose to that prospective purchaser all facts materially affecting the value or desirability of the property that an investigation would reveal.” CC §2079(a). As far as the buyer’s broker is concerned, there is both a comparable statutory duty and the even higher fiduciary obligations of utmost care, etc., which clearly impose similar inspection obligations. (The

TDS set forth in CC §1102.6 contains representations by both agents based on their inspections, adding an extra provision only for the seller's broker to disclose what she has learned from the sellers themselves.) Thus brokers, like home inspectors, owe a duty to buyers to inspect one- to four-unit properties and will be liable for negligently failing to do so, even though sellers don't have to do the same.

None of the above statutes apply to residential property containing more than four units. But half of what was said above still remains true: The buyer's agent still remains a fiduciary, has a duty to disclose to her principals what she actually knows about the condition of the property, and probably has a duty to inspect and report to them about discovered and discoverable defects. On the other hand, the seller's broker is not a fiduciary to the buyers, and thus has no common law or statutory duty to inspect on their behalf. In the case of larger properties, the seller's broker is liable only for withholding any actual knowledge of defects she had, not for failing to go looking for such defects. She is like the sellers themselves—liable to the buyers for fraud but not for negligence.

Subsequent owners of defective property can probably recover from brokers who fraudulently concealed defects in a prior transaction (as they can from sellers), because their loss is a foreseeable consequence of the fraud. For remote buyers to recover from a broker who negligently failed to discover a defect in a prior transaction, a court would have to find that the broker, like a home inspector, expected later parties to rely on statements she made to her own clients (in the TDS or otherwise), which seems somewhat unlikely.

3. *Are the standards for sellers, brokers, and home inspectors the same?* Although sellers are not subject to negligence duties, home inspectors and brokers are, and the statutory language differs, respectively. Home inspectors are supposed to identify material defects in “the mechanical, electrical, or plumbing systems or the structural and essential components” of the home. Bus & P C §7195(a). Residential brokers are supposed to “conduct a reasonably competent and diligent visual inspection” and disclose “all facts materially affecting the value or desirability of the property that an investigation would reveal.” CC §2079(a). These statutes certainly do not say the same thing, although they may end up imposing the same practical duties in any given situation.

Furthermore, the standard of care for home inspectors is based on the “degree of care that a reasonably prudent home inspector would exercise,” referring back to the professional organizations' standards mentioned in section 2b above. Bus & P C §7196. For brokers, the standard is “the degree of care that a reasonably prudent real estate licensee would exercise and is measured by the degree of knowledge through education, experience, and examination, required to obtain a license.” CC §2079.2. Although the range of inspection is wider for brokers—almost any fact can materially affect value, whether it is an itemized component or not, and investigative duties are not limited to on-site or physical problems—their inspections are probably expected to be less intense. Furthermore, home inspectors are on the hook for four years (Bus & P C §7199), whereas brokers are liable for only two. CC §2079.4.

Thus, there is the real possibility that liability may be imposed on one but not the other of the two professionals.

4. *What happens if more than one party is liable?* *Leko* holds that negligence liability is joint and several for the two professionals, meaning that the buyers can choose to sue or recover entirely from either defendant alone. (The indivisible injury requirement is met if both defendants failed to discover or disclose the same defect; the liabilities would be separate if different parties missed different defects, e.g., a plumbing leak was missed by the inspector, but a title or neighborhood problem was negligently not disclosed by the broker.)

Regarding intentional concealment, I suppose that the broker, the home inspector, and the sellers could all be jointly and severally liable for suppressing the same defect. Since I cannot think why three individuals would independently decide to fraudulently conceal the same defect from the buyers, a conspiracy seems necessarily involved, clearly justifying the shared liability.

When one defendant is negligent and another is fraudulent, *Leko* declares in passing that the liability is not joint and several, but certainly each tortfeasor is individually liable for the injury he or she caused. Because California measures damages for negligence and fraud differently—compare CC §§3333 and 3343—the amounts might well be different in that case.

Both *Leko* and *Expressions* uphold the application of equitable indemnity in allocating losses among the defendants. *Leko* allowed the brokers to cross-complain against home inspectors who were not originally sued by the buyers on the ground that the nondisclosures by both constituted a single injury to the buyers, even though the duties and theories of recovery might differ. *Expressions* permitted good faith settling developers and owners to seek indemnity from subcontractors even though the developers' liability was strict and the subcontractors' was based on negligence; comparative fault concepts could still be applied. I anticipate this would also apply when the shared liability (of sellers, brokers, and home inspectors) is based on fraud.

Thus, while buyers may content themselves with going after any one of the parties, the real struggle is probably going to be among defendants as to their proper share of the liability pot. Personal injury litigators deal regularly with comparative fault, and can probably do a decent job advising real estate attorneys how juries generally go about measuring such things.

5. *Defenses.* A footnote in *Leko* raised the interesting question of whether brokers can rely on inspectors' reports as a complete defense to liability to their principals. Civil Code §1102.4(c) allows a broker to hide behind the report of a "licensed engineer, land surveyor, geologist, structural pest control operator, contractor, or other expert." Because the appeal in *Leko* involved only the broker and the inspector (but not the buyers), the question of whether home inspectors are "other experts" was not before the court. On the one hand, there seems little sense in requiring a broker to reexamine the very same plumbing system that the home inspector has already inspected; on the other hand, it is not that burdensome for a broker (earning a respectable fee) to make a visual inspection of the same pipes herself, even if it is undoubtedly less competent and diligent than the home inspector's version of the same.

If equitable apportionment ultimately leapfrogs the negligence/fraud distinction, it is anybody's guess how a jury will apportion liability among (1) sellers who falsely told their broker that the plumbing was in good order, (2) the sellers' broker, who relayed that misstatement to the buyers without independently confirming it, (3) the buyers' broker, who failed to inspect at all, and (4) the home inspector, who inspected but failed to spot the leak.